Consumer Overdose and Why Consumer Protection is Good For Competition

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In *Competition Overdose,* authors Ariel Ezrachi and Maurice Stucke identify some important and compelling situations in which the free market is not delivering good outcomes, and how this might be addressed. It is a book that is both enjoyable and depressing to read.

Nonetheless, it is shocking that *Competition Overdose* had to be written. After all, there is nothing in it that we shouldn't already know. Every economist is taught, at an early stage in their economics education, that markets do not necessarily deliver good outcomes, and indeed are unlikely to do so, if there are market failures present. And while market power – as addressed by competition law – is one source of market failure, it is far from being the only one. Others include externalities (positive and negative), asymmetric information, and cognitive limitations.

The book describes some excellent examples of precisely these market failures. The 'competition overdose' it describes amongst elite universities results from two-way asymmetric information about the quality of both universities and students. The ignoble competition in the food industry depicted in the book reflects both asymmetric information and serious negative externalities. The final two examples of competition failures that it highlights – which both involve online platforms - reflect a combination of asymmetric information and cognitive limitations.

In terms of policy responses, however, the book emphasises that competition can deliver huge benefits, as well as harms. It cautions, quite rightly, against approaches which dispense with competition altogether. Indeed, it is not obvious that the examples in the book are even a result of 'too much' competition. Some of the markets described (hotel booking, online marketplaces) are arguably characterised by too little competition.

In fact, the real *competition overdose* described in the book is not an excess of competition, even though this can sometimes occur. Rather it is that we have developed excessive expectations of what competition can achieve. It is over-relied upon to solve market failures – a task for which is not well designed – and there is insufficient recognition that it can even exacerbate such market failures.

Again, this conclusion should not be surprising. We already have a wide array of regulations to address these wider market failures, from consumer protection to environmental standards, from food safety and animal welfare regulation to labour law. Perhaps the biggest takeaway from the book is that all of this wider legislation really matters. Competition will only deliver the huge benefits that it tantalisingly promises if it is pursued within a robust regulatory framework that ensures that competition works for, not against, the interests of consumers, workers, the environment.

In this short article, I focus on one particular aspect of this wider regulatory environment, consumer protection. *Competition Overdose* spotlights the importance of consumer protection for ensuring that competition delivers good outcomes, and I discuss and confirm this. However, I also make an additional and important point, not covered in the book: consumer protection is good for competition itself.

The critical role of consumer protection in enabling 'noble' competition

The importance of consumer protection in market-based economies is well established and has been increasingly formalised through legislation. President John F. Kennedy first introduced the US Consumer Bill of Rights in 1962, and the United Nations first adopted Guidelines for Consumer Protection in 1985. Across many jurisdictions, consumers are now protected by law from unsafe products, fraud, deceptive advertising and a variety of other unfair business practices.

Yet consumer protection regulation is often seen as weaker, and of lower priority, than competition law. Outside of financial services, the enforcement of consumer protection regulation frequently receives fewer resources than competition law enforcement, and the sanctions for breach are weaker.

Some justify this imbalance on the basis of a serious misconception; that if we can ensure effective competition, then this will itself protect consumers. This is simply not true, as is shown clearly in *Competition Overdose.* While competition can sometimes help protect consumers, it certainly cannot be relied upon to do so.

This crucial finding is supported by a whole host of academic research. There is simply too great an imbalance of bargaining power and too great an asymmetry of information between firms and consumers, for naked competition to be expected to deliver good outcomes. The position is exacerbated by consumers' cognitive limitations, and the potential for firms to manipulate consumer decision-making through the way in which they present choices (known as 'choice architecture').

A serious re-evaluation of the importance of consumer protection is therefore overdue. In particular, it deserves far greater recognition for its critical role in enabling effective competition that actually delivers good consumer outcomes.

Consumer protection and competitive markets: A brief introduction

At one level, whenever firms know substantially more about their products than do consumers, it is entirely obvious that consumer protection may be required to ensure good market outcomes. If firms are able to engage in naked fraud – selling stakes in investments that don't exist, or selling 'snake oil' as a health cure – then many will eagerly do so. If enough consumers are conned, it will be a profitable strategy.

Of course, some consumers might be smart and realise that these products are worthless. However, unless they can clearly identify which sellers are honest and which are fraudsters, their best response will simply be to stay out of the market and avoid purchasing. The incentives of traders to remain honest in such a market will be weak, and there is a serious risk that only the fraudsters will survive. None of this is good.

It is well understood that consumer protection can solve this problem and restore more 'noble' competitive incentives, by requiring that sellers provide what they promise. This ensures a level playing field on which firms cannot gain market advantage by offering consumers a bad deal.

However, consumer protection also has a more subtle and sophisticated role to play, even in the absence of all-out fraud. Markets deliver good consumer outcomes most effectively if the "demand side" of the market works well. This involves consumers, to the greatest extent possible, making well-informed active choices to buy the products that best suit their needs. This in turn requires them to ***attend*** to (or engage with) the market in question in the first place, ***access*** relevant information about the available products, ***assess*** that information, and finally ***act*** on that information. These four 'As' underpin effective consumer decision-making and are critical for competition delivering good outcomes.[1]

In practice, however, real consumers struggle with all of these elements. They have limited information and a limited ability to process information. They face search and switching costs. They have cognitive limitations and exhibit behavioural biases. They make decisions on the basis of imperfect information. Their ranking of options may not be either coherent or consistent. They may fail to select their preferred option, either by mistake or due to misdirection by the seller. In addition, evidence on consumer inertia suggests that consumers procrastinate, whether due to time-inconsistent preferences, overoptimism regarding future action, or underestimation of future switching costs. They may simply lack self-control or forget to complete the process of finding better suppliers.

Importantly, it can also be both rational and efficient for consumers to choose not to fully engage or inform themselves. If a consumer were always to scrutinize all the terms and conditions of the services they signed up for, they would have little time to do anything else; they instead tend to "click to accept," without giving this "small print" any serious scrutiny.[2]

However, these various factors, which limit the effectiveness with which consumers *attend* to, *access*, *assess*, and *act* on relevant information have a variety of important implications for competition.

Consumer protection as a limit on distorted competition

First, even if firms are not acting strategically to confuse or deceive consumers, their competitive incentives will naturally be influenced by how consumers respond to their offerings. Even "competitive" and "non-deceptive" markets can generate poor consumer outcomes if consumers do not move towards the market options that provide lower prices,

[1] Amelia Fletcher, *Disclosure as a tool for enhancing consumer engagement and competition*, 5(2) BEHAVIOURAL PUB. POLICY 252 (2021).
[2] See Yannis Bakos, et al., *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43(1) J. LEGAL STUD. 1 (2014).

higher quality, or less exploitation, not least because firms will not then be incentivised to offer these better options.

Critically, competition can also occur on the “wrong” dimensions. If consumers ignore an aspect of the product or its price, competitive firms will be incentivised to compete aggressively on the salient elements, which consumers focus on, and to exploit consumers on any neglected dimension.[3] So if consumers focus overly on food prices, and give insufficient attention to food standards, competition will lead suppliers to cut corners on the latter. Similarly, if consumers mis-predict their own future actions — such as being overoptimistic regarding their ability to pay off loans — firms will compete hard on the element that consumers are focused on (easy access to loans, low upfront fees), and exploit the elements where they benefit from consumers' mispredictions of their own behaviour (interest rates, late payment charges).[4]

Unregulated profit-maximizing firms in such settings—knowingly or unknowingly—exploit naïve consumer misperceptions and this can lead to undesirable consequences.[5]

Consumer protection regulation can usefully protect against such unsafe or unfair outcomes. A consumer who purchases food in a supermarket should not be expected to carefully check whether the available food is toxic; they should be able to trust in food safety regulations to protect them from the worst eventualities. When consumers are protected in this way from “hidden nasties,” they can more safely focus their scarce attention on the salient aspects of the product, and this is likely to result in better choices and more desirable market outcomes.

Consumer protection as a facilitator of 'noble' competition

Alongside the need for a protective regulatory framework, *Competition Overdose* also argues that competition will deliver better outcomes if market actors take a more ethical approach to the firm's activities. The book focuses on consumers, but this could equally involve a firm's workers or its investors.

Clearly this is happening to some extent. The actors in markets are individuals and do behave according to their own ethical frameworks. Increasingly workers, investors and consumers are all having some impact on the ethical behaviour of firms, from moves towards ethical sourcing in response to consumer pressure, to investors forcing firms to take ESG (environmental, social and governance) issues more seriously, to Google

[3] For example, Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopi , and Information Suppression in Competitive Markets*, 121(2) ECON. J.Q. 505 (2006).
[4] For example, Sule Alan, et al., *Unshrouding: Evidence from Bank Overdrafts in Turkey*, 73(2) J. FIN. 481 (2018); Stefano DellaVigna & Ulrike Malmendier, *Paying Not to Go to the Gym*, 96(3) AM. ECON. REV. 694 (2006)
[5] See Mark Armstrong & John Vickers, *Consumer Protection and Contingent Charges*, 50(2) J. ECON. LIT. 477 (2012); PAUL HEIDHUES & BOTOND KÖSZEGI, HANDBOOK OF BEHAVIOR ECONOMICS – BEHAVIORAL INDUSTRIAL ORGANIZATION 517 (2018); Paul Heidhues, et al., *Inferior Products and Profitable Deception*, 84 REV. ECON. STUD. 323 (2017); Paul Heidhues and Botond Közsegi., *Naïveté-Based Discrimination*, 132(2) ECON. J.Q. 1019 (2016).

apparently terminating plans for a controversial censored search engine in China following employee pressure[6].

These ethical forces can be powerful. However, this approach may itself require facilitative consumer protection regulation. For example, consumers and investors can only be confident in choosing green companies if they can be assured that their claimed green credentials are valid. Hence, there are strong moves in both financial services and general consumer markets towards addressing 'greenwashing' concerns.

Consumer protection as a tool for enhancing competition

Third, if consumers are not making effective choices across products, competition itself can be harmed. This can occur for a variety of reasons.

(i) Enhanced incumbency advantage and reduced innovation

If consumers feel that they are unable to trust the market, then they may well lack the confidence to try new products or suppliers. They will be more inclined to buy from established incumbent sellers who may be no better than entrants, but who have earned consumer trust by selling in previous periods. This can clearly increase the incumbency advantage – and consequently the market power – of such suppliers, while creating a barrier to entry and expansion for smaller rivals. Likewise, consumers in this situation may be uninclined to try innovative new products, which will in turn reduce incentives for firms to invest in innovation.

Competition and innovation can both be improved by consumer protection law that allows consumers to choose safely between products, including from less well-established sellers, secure in the knowledge that a mistaken choice will not have significant adverse consequences.[7]

(ii) Strategic dampening of competition

Given the critical importance of the demand side for competitive outcomes, it is perhaps unsurprising that firms may have a strategic incentive to impede informed consumer decision making with a view to dampening competition. Rather than seeking to gain customers through offering good value for money, firms may instead choose to shroud their poor value for money by acting strategically to make product comparison hard and generate consumer confusion.

The inability of consumers to compare products can be a source of profits and oligopoly power, even when there are several suppliers.[8] Moreover, when markets become more

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[6] See Ryan Gallagher, *Google's Secret China Project "Effectively Ended" After Internal Confrontation,* THE INTERCEPT, 17 December 2018, https://theintercept.com/2018/12/17/google-china-censored-search-engine-2/.
[7] Paul Heidhues, et al., *Browsing versus Studying: A Pro-market Case for Regulation*, 88(2) REV. ECON. STUD. 708 (2021).
[8] See Tibor Scitovsky, *Ignorance as a source of monopoly power*, 40(2) AM. ECON. REV. 48 (1950); Peter Diamond, *A model of price adjustment*, 3(2) J. ECON. THEORY 156 (1971).

competitive, firms can have increased incentives (unilateral or shared) to make product comparisons more difficult, or otherwise obfuscate, in order to avoid the resulting downward pressure on profit margins.[9] Likewise, if an established firm is able to deter its consumers from shopping around – for example through obfuscation or measures to decrease consumer engagement and increase inertia – it will achieve increased market power and incumbency advantage; it becomes less likely to lose its customers to rivals even if the latter offer a theoretically more attractive deal.

In this situation, consumer protection regulation that makes it harder to obfuscate or inhibit engagement can directly reduce market power and enhance competition, to the benefit of consumers.

(iii) Strategic leverage

Where a firm has an existing customer relationship, it has a natural advantage in selling additional products to that customer. However, it may also be able to unfairly exploit its advantageous position through selling additional products on a misleading basis.

For example, consumers can exhibit strong "default bias", especially where they trust the source of the default option.[10] If an additional product or service is offered as a default choice, for example through a pre-ticked box online, this can nudge consumers towards making purchases without shopping around for the best deal (or even making purchases that are entirely unsuitable or unnecessary). This in turn limits the ability of alternative providers of these products to gain customers, even if they offer far better value for money or are more suitable. For this reason, in the EU, online sellers are now prohibited from selling additional products or services through pre-ticked boxes.

Similarly, the UK Advertising Standards Authority (ASA) recently upheld a complaint against Amazon in relation to its advertising of its Amazon Prime service, which is complementary to its core online shopping service.[11] The complaint concerned a particular choice screen which included two buttons appeared to present different options as regards Amazon Prime. In fact, both buttons led to customers agreeing to sign up. The only route to not signing up was to click on a link that was far less salient than the two buttons. The ASA considered that this framing was likely to mislead consumers into taking Prime. In doing so, Amazon was effectively leveraging its core market position into this additional service.

Consumer protection, by limiting the ability of sellers to market exploitatively to their existing customers, can clearly play a valuable role in limiting such unfair strategic leverage, and so fostering more effective competition.

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[9] See Ran Spiegler, *Competition over agents with boundedly rational expectations*, 1(2) THEORETICAL ECON. 207 (2006); Bruce Carlin, *Strategic price complexity in retail financial markets*, 91(3) J. FIN. ECON. 278 (2009); Ioana Chioveanu & Jidong Zhou, *Price competition with consumer confusion*, 59(11) MGMT. SCI. 2450 (2013).
[10] See Jon Jachimowicz et al, *When and why defaults influence decisions: A meta-analysis of default effects*, 3(2) BEHAVIOURAL PUB. POLICY 159 (2019).
[11] *See* Advertising Standards Authority Oct. 30, 2019 G19-1021643, *ASA Ruling on Amazon Europe Core Sarl* (UK), https://www.asa.org.uk/rulings/amazon-europe-core-sarl-G19-1021643.html.

(iv) Strategic enhancement of “bottleneck” market power

Finally, in the context of multi-sided platforms, consumer protection regulation can have an unexpected additional benefit for competition. Such platforms can exhibit “bottleneck” market power in relation to one side of the market – typically third party sellers or advertisers – if they provide a critical route to consumers on the other side of the market. This in turn is most likely to occur when consumers “single home” or do not shop around.

This of course provides an additional incentive for platforms to act strategically to limit consumers’ ability to “multi-home” or shop around. While consumers may not suffer directly from such action, the additional market power that platforms gain in their dealings with third party sellers will in the end harm consumers through driving up the costs faced by these sellers. Consumer protection regulation, which is inherently intended to foster consumers’ ability to shop around, can be invaluable in ameliorating this problem.

In addition, platforms may be able to enhance their “bottleneck” position further by obfuscating on their own platform. For example, the UK Competition and Markets Authority has taken action against hotel online booking sites for failing to make clear that the hotel rankings they provide, ostensibly to reflect the consumers’ best interests, are in fact influenced by commercial factors, such that hotels are effectively able to buy higher rankings. This blurring of the boundary between organic search rankings and paid for advertising not only left consumers at risk of making poor choices but also conferred greater “bottleneck” power on the platforms – they could charge hotels a lot to improve their position in these misleading rankings. Again, consumer protection regulation, by ensuring that consumers are not misled in this way, should help to reduce market power and enhance fair competition.

Conclusion

Effective consumer protection can therefore be seen as a key component of effective competition policy.

This does not, of course, mean that consumer protection law is always beneficial. Mandating disclosure of relevant information will not improve consumer choice if consumers simply ignore it, and it could even harm consumer decision making if consumers feel overloaded. Likewise, simplified disclosure can be distortionary if the simplification is ill-suited to the choice being made. For example, the use of APRs can lead to worse choices regarding short-term credit options (Bertrand and Morse (2011)).[12] Consumer protection law can also create detriment if, in protecting the naïve, it inhibits firms from offering products which more sophisticated consumers would both understand and value.

However, the fact that certain protections can have some negative consequences does not undermine the general need for, and benefits of, consumer protection law. Rather, the

[12] For example, Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing*, 66(6) J. FIN. 1865 (2011); Fabián Duarte & Justine Hastings, *Fettered Consumers and Sophisticated Firms: Evidence from Mexico’s Privatized Social Security Market*, (Nat’l Bureau of Econ. Rsch., Working Paper No. 18582, 2012).

observation simply demonstrates that regulation of this sort often involves trade-offs, and potential negative consequences should clearly be considered carefully in regulatory design.

As *Competition Overdose* so forcefully argues, competition has huge benefits, but also downsides. Consumer protection has a critical role to play both in limiting these downsides and in enhancing competition itself.

A final note. Some of the examples provided above relate to the digital sphere, and there is an urgent need to revisit and bolster consumer protection legislation in the context of digital platforms.[13] Consumer protection concerns are elevated in this arena by several key factors. The high levels of concentration in many digital platform markets, combined with the potential for "bottleneck" market power, mean that the competition considerations set out above are likely to be especially critical. Digital platforms also provide important routes to market for third party trader and receive revenues for playing this intermediary role. They thus have a critical role to play in ensuring that these traders act within the law and treat consumers fairly. Not only are they uniquely well positioned to police such conduct, but they also have a responsibility to do so given that they gain from the earnings of these traders.

In addition, digital platforms frequently have huge quantities of individual consumer data, complete control over the user interface and thus the choice architecture facing consumers, and the ability to run extensive "A/B testing" to assess how consumers react to changes in this architecture, potentially on a personalised basis. All of this can potentially be utilised strategically by digital platforms to influence consumer decision-making in a way that is beneficial to the platform but not necessarily the consumer.

All of this means that consumer protection needs to be more firmly brought within the sights of policy makers and enforcers, including those tasked with ensuring competition is healthy and delivers good outcomes.

[13] Amelia Fletcher et al, *Consumer Protection for Online Markets and Large Digital Platforms*, Policy Discussion Paper No. 1, Tobin Center for Economic Policy at Yale: Digital Regulation Project (2021).